Domtar Inc.
Annual Report 1985

Hardwood

Softwood

Domtar's mission

Domtar's mission is to:

- serve markets world-wide for products manufactured from natural resources in North America;
- focus on selected businesses in forest products, packaging, building and chemical products where the Corporation maintains a leading position and is cost-competitive;
- achieve long-term growth in earnings and share value through internal development and balanced diversification in compatible fields.

In addition, Domtar's primary objective is to provide a sufficient return on investor capital to allow it to compete favourably in financial markets for funds necessary to support its strategic growth.

To assist the reader's understanding of Domtar's mission, one of its facets is featured as a theme of each Annual Report. In 1984, the focus was on Domtar's markets. This 1985 report highlights Domtar's natural resources and the raw materials it uses in its manufacturing processes.

Gypsum

Natural gas

Salt

A complete listing of Domtar's businesses is provided on the inside back cover of this report.

Highlights

For the year	1985	1984	1983
Millions of Canadian dollars			
Sales	**$2,130**	$2,044	$1,820
Earnings before extraordinary items	**96**	86	39
Net earnings	**110**	90	38
Cash flow from operations	**205**	177	120
Capital investments			
Existing businesses	**284**	133	108
New businesses	**16**	27	—
Per common share			
Earnings before extraordinary items	**$ 2.33**	$ 2.22	$ 1.05
Net earnings	**2.70**	2.34	1.03
Dividends	**0.79**	0.60	0.50
Cash flow from operations	**5.17**	4.70	3.27
Return on common shareholders' equity†	**12.3%**	13.0%	6.6%
In millions except market price			
Common shares			
Average number of shares outstanding	**38.6**	36.6	36.4
Market price (Toronto Stock Exchange)			
High	**$ 23¼**	$ 17½	$ 16¼
Low	**$ 16⅝**	$ 14½	$ 9¾
Trading volume			
Canada	**8.6**	5.7	5.5
United States	**2.9**	1.0	1.2
At year-end			
Ratio of long-term debt to shareholders' equity	**24:76**	30:70	35:65
Book value per common share	**$19.71**	$17.89	$16.20

†*See definition on page 46*

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Domtar Inc.
Directors and Officers

Board of Directors

J.A. Gordon Bell (1)
Toronto, Deputy Chairman of the Board, President and Chief Operating Officer, The Bank of Nova Scotia

Gilles Blondeau (1) (2) (3) (4)
Montréal, President, Optimum Group Inc.

Guy Coulombe (1) (2)
Montréal, President and Chief Executive Officer, Hydro-Québec

Robert Desprès (3)
Québec, Chairman of the Board, Atomic Energy of Canada Limited

Denis Giroux (4)
Montréal, Vice-President — Corporate Investments, Caisse de dépôt et placement du Québec

Margaret L. Hamilton
Toronto, Consultant, Thomson Newspapers Limited

Robert E. Heneault (2)
Toronto, Executive Vice-President, Stelco Inc.

John G. Kirkpatrick, Q.C. (3) (5)
Montréal, Senior Partner in the legal firm of Ogilvy, Renault

Jean-Claude Lebel (1) (2) (5)
Montréal, Chairman of the Board, President and Chief Executive Officer, Société générale de financement du Québec

John C. Major, Q.C. (3)
Calgary, partner in the legal firm of Bennett Jones

Rémi Marcoux (2)
Montréal, President, Groupe Transcontinental G.T.C. Ltée

Robert Marcus
San Francisco, President and Chief Executive Officer, Alumax Inc.

Raymond R. Pinard
Montréal, Executive Vice-President and Chief Operating Officer, Domtar Inc.

Michel Plessis-Bélair (1) (3)
Montréal, Executive Vice-President, Société générale de financement du Québec

Yves Pratte, Q.C. (1) (2) (5)
Montréal, Chairman of the Board, Domtar Inc.; partner in the legal firm of Clarkson, Tétrault

James H. Smith (1) (2) (4) (5)
Montréal, President and Chief Executive Officer, Domtar Inc.

Edward J. Waters (4)
New York, Vice-President, Kidder, Peabody & Co. Incorporated

Lorne C. Webster (4)
Montréal, Chairman of the Board and Chief Executive Officer, Groupe Prenor Ltée

Member of the:
(1) Executive Committee
(2) Executive Management and Compensation Committee
(3) Audit Committee
(4) Investment Committee
(5) Nominating Committee

Officers

Yves Pratte, Q.C.
Chairman of the Board

James H. Smith
President and Chief Executive Officer

Raymond R. Pinard
Executive Vice-President and Chief Operating Officer

Roger A. Ashby
Vice-President of the Corporation;
President, Pulp & Paper Products Group

Steven S. Danyluk
Vice-President, Research and Environmental Technology

Pierre Dupuis
Vice-President of the Corporation;
President, Construction Materials Group

G. Andrew Edwards
Assistant Treasurer

Wilfrid L.P. Fournier
Vice-President, Employee Relations

André Gascon
Vice-President and Secretary

W. Boyd Henderson
Vice-President, Engineering

Frederick E. Hertha
Vice-President, Energy

Neil Martin
Vice-President of the Corporation;
President, Chemicals Group

Jan A.J. Meyers
Vice-President of the Corporation;
Vice-President and General Manager, Fine Papers division

T. Brian Nutter
Controller

Gilles Pharand
Assistant General Counsel and Assistant Secretary

Elmer R. Puddington
Vice-President of the Corporation;
President, Packaging Group

Derek J. Speirs
Vice-President, Finance and Corporate Development

Halford M. Wilson
Treasurer

Report of directors

Earnings continue to improve

Net earnings in 1985 amounted to $110 million or $2.70 per common share, compared to $90 million or $2.34 per common share in 1984. In both years, extraordinary gains were realized from using prior years' tax losses in the United States and the sale of certain assets. These totalled $14 million or $0.37 per common share in 1985 and $4 million or $0.12 per common share in 1984.

All per-share amounts in this report reflect the two-for-one stock split which occurred on June 14, 1985. On June 26, 1985, an additional 3.4 million common shares were sold, which increased the average number of common shares outstanding in 1985 to 38.6 million, compared to 36.6 million in 1984.

Business factors Although total operating profit continued to improve, results varied from one Operating Group to another. The Construction Materials Group benefitted from a strong demand for its products, particularly gypsum wallboard in Eastern Canada, the Northeastern United States and California. The Chemicals Group's operating profit improved as a result of the strong weather-related demand for ice control salt and higher selling prices. The Packaging Group's operating profit declined in 1985 as increased operating costs due to inflation more than offset the impact of increased shipments of corrugated containers and the benefit of the mid-1984 price increase for corrugated containers and containerboard. The Pulp & Paper Products Group's operating profit declined in 1985. Sales volume was higher in fine papers and lumber, virtually unchanged in newsprint, but lower in pulp and in groundwood specialties due to the start-up of new equipment. Profit margins for both the pulp and fine papers businesses declined due to lower selling prices and increased costs as a result of inflation. The newsprint and groundwood specialties businesses had a higher operating profit due to the effect of mid-year 1984 newsprint price increases and the cost benefits derived from the conversion to the 100% thermo-mechanical pulping process at the Donnacona mill, Québec. Gas and Oil maintained the same level of operating profit as in 1984. The Corporation benefitted from the strong United States dollar relative to the Canadian dollar.

The results for both years were adversely affected in varying degrees by strikes at three major locations — an 11-month strike at the Lebel-sur-Quévillon, Québec softwood pulp mill which began in June 1984 and was settled in May 1985, and three-month and four-month strikes in 1985 at the Goderich, Ontario salt mine and the gypsum wallboard plant in Caledonia, Ontario respectively.

Strategic action

Mission In response to a perceived change in future economic environments, Domtar reformulated its mission statement in 1983. This is outlined on the inside cover of the annual report. Domtar's mission is to continue to expand in selected diversified businesses providing higher growth and return. Domtar's thrust since 1983 has been to follow business strategies appropriate to this mission.

Domtar's Board of Directors, seated from left, Margaret L. Hamilton, Jean-Claude Lebel, Yves Pratte, Q.C., James H. Smith, Raymond R. Pinard: Standing, Rémi Marcoux, Michel Plessis-Bélair, John C. Major, Q.C., Lorne C. Webster, Robert E. Heneault, Gilles Blondeau, Robert Després, Robert Marcus, John G. Kirkpatrick, Q.C., Denis Giroux, Guy Coulombe, Edward J. Waters and J.A. Gordon Bell. Additional information concerning the Board members is provided *on page 2.*

1985 actions Major actions taken to implement key business strategies included:

- Conversion of the Dolbeau, Québec newsprint mill to full thermo-mechanical pulping, to be completed by 1987, together with adding a second production line at the adjacent sawmill. This will significantly improve the mill's cost effectiveness and meet environmental requirements.

- Installation of a new paper machine to produce corrugating medium at the mill in Trenton, Ontario and of a new corrugator at a packaging plant in Toronto. This is part of the Packaging Group's ongoing program to increase capacity, improve productivity and meet new demands for higher quality.

- Acquisition of two gypsum wallboard plants in Western Canada as part of a plan to achieve a broader participation in the North American market.

- Conversion of the Amherst, Nova Scotia evaporated salt plant to a lower-cost production process.

- Disposal of certain operations — the Canadian masonry division and the solar salt facility in Utah.

- Rehabilitation of the Windsor, Québec pulp and fine paper mill into a world scale facility as part of a program to keep Domtar's fine paper mills competitive.

Windsor mill rehabilitation

As reported in the 1984 Annual Report, Domtar was considering a major investment in the growing fine paper industry by rehabilitating its Windsor complex so it would be cost-competitive in the climate of continuing Canadian tariff reductions and be in compliance with environmental regulations. However, there were two adverse factors: higher Canadian financing and construction costs relative to what United States competitors would have to pay.

Government assistance for the transition period covering the $870 million rehabilitation of the complex was needed to alleviate these disadvantages. In April 1985, Domtar accepted a proposal which included a Federal-Québec government interest-free loan of $150 million to be received at $30 million per year over five years, with each portion being repayable in 10 years, and a $22 million grant from the Québec government. The acceptance of this proposal, which superseded any prior indications of government assistance, provided the necessary confidence for the Corporation to proceed with the project.

Financing

Current To support Domtar's overall capital program, including Windsor, a $75 million common share issue (including the sale of Investment Tax Credits) and a 10-year $500 million syndicated bank line of credit were arranged in 1985. This equity issue plus 1985 earnings have increased the common shareholders' equity to $800 million from $660 million. In February 1986, a $75 million long-term preferred share issue was effected.

Later Additional financing required during the period of Windsor's construction and start-up will be mostly longer-term debt. Throughout this period, Domtar will continue its policy of maintaining a sound balance sheet.

Employee relations

Safety Accident-free operations continue to be a primary objective of management and employees. The result in 1985 has been a reduction of 10% in the number of lost-time accidents. However, the severity rate increased, due to two fatalities which occurred during the year. Greater emphasis on safety is clearly needed to achieve the objective.

Labour In 1985, 35 collective agreements were renewed. In general, the process of negotiation went well, particularly in the renewal of the agreements covering the corrugated containers plants in Eastern Canada. However, there were three major strikes during 1985. Management has therefore intensified its efforts to work with its employees and their unions to establish an improved relationship for the resolution of mutual problems.

Dividends

The quarterly dividend on the common shares was raised 25% in the third quarter of 1985 to $0.22 from $0.175 per common share. As a result, the annual dividend was $0.79 per share in 1985, compared to $0.60 in 1984.

Outlook for 1986

Domtar's profitability is affected not only by the economy in general, but also by supply-demand forces within the markets it serves. Economic growth in North America should continue into 1986, thereby increasing demand for many of Domtar's products. Housing starts should continue strong. The businesses within the Pulp & Paper Products and Packaging Groups face situations where operating rates or prices are likely to remain depressed due to worldwide oversupply. Lower valued Canadian and United States dollars versus other foreign currencies would be beneficial.

In 1986, there are 35 labour agreements to be negotiated, none of which has a significant overall impact on Domtar.

Public issues

Free trade Free trade with the United States will significantly affect Domtar. Its precise impact on the Corporation is difficult to assess at this time, since Domtar has 18 businesses serving differing markets, principally in North America. Harmonization of United States — Canadian legislation will be necessary to cover such difficult non-tariff issues as allowing prices to be set freely, within defined fair trade rules, irrespective of the international border, minimizing customs documentation and eliminating preferential buying by governments. This will help realize the concept of one large market. However, provided that a fair deal is negotiated, non-tariff issues are resolved, and given a period of transition to enable affected businesses to adjust to the new environment of competition from United States producers, Domtar believes that free trade will be beneficial.

Government deficits Domtar is concerned at the size of the Federal and provincial deficits in Canada. Unless action is taken to reduce them, the ability of Canadian governments to act effectively will be severely curtailed. Despite Canada's many attributes, external confidence will erode. Resolute leadership by the Federal government will be required to achieve a meaningful reduction in the face of efforts by various interest groups to minimize the impact of any proposed reduction on their respective spheres of activity. Deficit reduction should focus on reduced government spending and a reorientation of such expenditures to promote economic growth for the benefit of all Canadians. Without vigorous action by the Federal government, a combination of high inflation, high interest rates, high unemployment and a declining Canadian dollar emerges as a conceivable outcome.

Change in the Board of Directors

In October, Margaret L. Hamilton, most recently President and Chief Operating Officer of Thomson Newspapers Limited, Toronto, was elected to the Board of Directors.

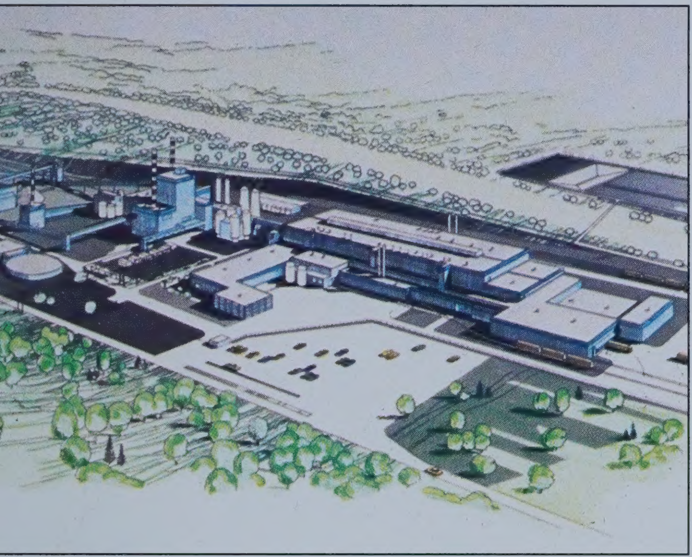
Appreciation

The people employed by Domtar are a major reason for its improved results and the key to its future success. The directors recognize with appreciation and gratitude the skills and efforts of the Corporation's employees, who performed with such dedication throughout 1985.

Yves Pratte, Q.C.,
Chairman of the Board

James H. Smith,
President and Chief Executive Officer

Rehabilitation of Windsor fine paper mill



Opportunity

The decision to rehabilitate the fine paper facility at Windsor was based principally on four factors — a growing market for fine papers, existing business strengths, the need to be a low cost producer and the advantages of a particular mill site.

North America's fine paper market totals some 10 million metric tonnes. Mainly due to increasing usage throughout business, demand is growing at 3% to 4% a year, which is faster than the general economy. This is expected to continue into the 1990's.

Domtar considers that its Fine Papers division has the underlying strengths to grow with this market:

- A long-standing reputation as a dependable supplier.
- Recognized quality products through research and technical expertise.
- Close proximity to the large Northeastern North American market.
- Marketing experience and know-how.

The need to be a low-cost producer dictated constructing a mill on a scale to compete worldwide. The choices were to build a greenfield facility or rehabilitate an existing site to be fully cost-competitive.

The decision to rehabilitate Windsor was due to:

- regional abundance of cost-competitive hardwood.
- low cost electricity.
- existing infrastructure.
- skilled labour force.
- some services continuing to be used.

As a result, Domtar is moving from a high-cost operation facing environmental regulation problems to a low-cost position which is expected to withstand the risk of continuing tariff reductions and foreign competition.

Manufacturing capacity

When the Windsor rehabilitation program is completed, and the existing capacity is permanently closed, divisional capacity will be 650,000 tonnes — a net increase of 220,000 tonnes, of which 100,000 tonnes is to be added in late 1987 and 120,000 tonnes in late 1989.

Progress to date

By the end of 1985, most of the machinery and equipment had been ordered for the pulp mill and the first paper machine. Of the $870 million total fixed asset investment, including land, some $295 million has already been committed. The site preparation and the foundations for the paper machine, pulp and recovery boiler areas were completed. Work continued throughout the winter.

DOMTAR'S NATURAL RESOURCES

Pulp & Paper Products Group

For Pulp & Paper Products and Packaging, wood fibre is the principal raw material. In 1985, 72% of the fibre needs of Domtar's mills was obtained from its own forest limits. The remainder was purchased from independent suppliers under long and short-term contracts.

The Corporation holds licences and timber limits from the provinces of Québec and Ontario for cutting rights on approximately 4.4 million hectares (17,000 square miles) of forested land, 59% in Québec and 41% in Ontario. The Corporation owns approximately 371,000 hectares (1,430 square miles) of forested freehold land, principally in Québec and Ontario, but also in Maine and New York.

The resource base

Domtar's timber reserves provide the base for indefinitely sustained production at present — and gradually increasing — levels.

In recent years, Domtar has sharply intensified its sylvicultural activities to speed regeneration of cut-over forest lands. These include planting, seeding, thinning stands, developing genetically superior tree species, fertilizing nutrient deficient sites and, where permitted by province or state regulation, applying insecticides and herbicides.

The principal threats to Domtar's timber resources are infestations by insects such as the spruce budworm, and the leaching of essential nutrients from forest soils through the precipitation of airborne pollutants. Forest fires have to date not seriously affected Domtar's forest reserves.

Electrical energy is another key renewable resource required in pulp and paper production. Domtar is fortunate to have access to abundant and low-cost supplies, particularly in Québec.

Fine papers

Cornwall mill

Of the hardwood consumed at Cornwall, 85% is provided from the region, under short-term contracts. The remaining 15% is supplied from Domtar's limits and from privately owned plantations in Eastern Ontario and Northern New York State, located within 100 kilometres (62 miles) of the mill.

The forest base supplying the mill consists of 90% mixed hardwoods. Domtar is pursuing a program to grow hybrid poplars which attain commercial maturity within 15 years. The regional hardwood supply is good, with the Cornwall mill being the only major consumer.

Windsor mill

The Windsor mill's fibre needs will double on completion of the rehabilitation program in 1989. Domtar limits located within 80 kilometres (50 miles) of the mill meet 30% of the requirement. The balance of the fibre is principally supplied under a 10-year renewable contract with the regional wood producers board.

The mix of species within the harvest area consists of 60% hardwood and 40% softwood. The mill is the only major consumer of hardwoods in a region where the species are in abundant supply. An excellent road infrastructure facilitates delivery.

St. Catharines, Toronto and Beauharnois mills

The fibre needs of Domtar's three non-integrated fine paper mills are met through purchases of both hardwood and softwood pulps from internal sources.

A
B C

A. Intensive sylvicultural techniques speed regeneration of more productive trees, such as this stand of young hybrid poplars near Cornwall.

B. Low-cost hydro-electric energy is a vital resource for the energy-intensive pulp and paper industry.

C. High-density hardwood is abundant within economical distance of the Cornwall and Windsor mills.

DOMTAR'S NATURAL RESOURCES

Pulp & Paper Products Group (continued)

Newsprint, groundwood specialty papers, pulp and lumber

Dolbeau newsprint mill

The Dolbeau newsprint mill is entirely supplied with softwood from three Crown limits covering 1.1 million hectares (4,247 square miles) and mainly situated within 150 kilometres (93 miles) of the mill. Consisting of 87% spruce and balsam, this source provides fibre of excellent quality in quantities sufficient to meet the mill's foreseeable needs. Control of spruce budworm infestations is a constant challenge in parts of the limits. All of the fibre is processed through Domtar's sawmill adjacent to the mill.

Donnacona groundwood specialties mill

One-third of the fibre supply comes from Domtar's own lands and Crown limits totalling 106,000 hectares (409 square miles) and situated within 150 kilometres (93 miles) of the mill. 26% is provided through a long-term supply agreement with an associated sawmill. The remaining 41% is produced by independent suppliers or purchased on the open market. The limits consist mainly of softwoods of excellent fibre quality.

Lebel-sur-Quévillon pulp mill

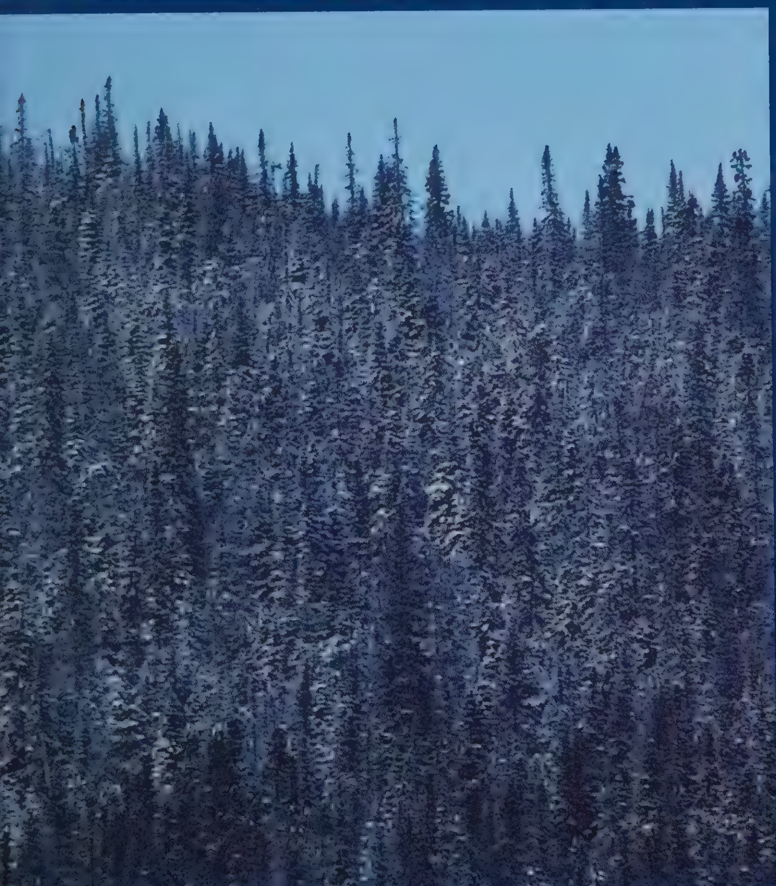
Fibre is supplied from Crown limits covering approximately 1.5 million hectares (6,150 square miles) and consisting entirely of softwood species. The lengthy 90-to-100 year growth cycle for softwood in this northerly region is offset by the sheer size of the limit, enabling the mill to be supplied on a sustained yield basis. The abundant fibre supply, flat terrain and the proximity of these limits to the mill provide significant cost advantages. All of the fibre is processed either through Domtar's sawmill adjacent to the pulp mill or through sawmills operated by independent suppliers.

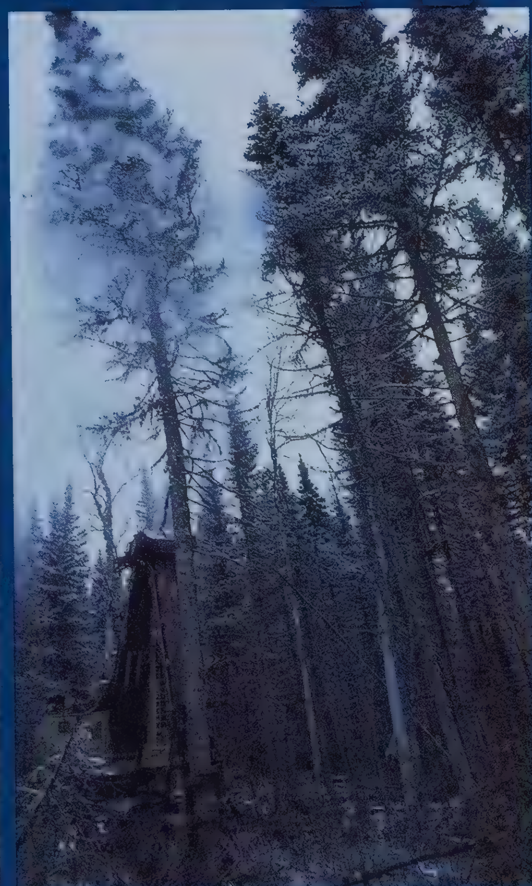
A. Domtar's timber resources in Québec can supply almost all the softwood fibre requirements of its pulp mill and two of its paper mills.

B. Mechanized techniques speed harvesting and make efficient use of available wood fibre.

C. On the Dolbeau limits, specially developed 50-wheel tandem trailers, 58 metres long, haul 150 tonnes of wood in a single load.

D. Wood chips supplied by Domtar's sawmills and independent suppliers are the main fibre source for its Québec mills.





DOMTAR'S NATURAL RESOURCES

Packaging Group

Red Rock mill

This mill principally produces linerboard and also manufactures newsprint. Of its fibre requirements, 80% is supplied under Forest Management Agreements with the Government of Ontario from three Crown limits covering 1.8 million hectares (6,950 square miles) in Northwestern Ontario plus small holdings of freehold land. The 20% remainder is provided by purchases from independent suppliers. The mix of species on these limits consists of 70% softwood and 30% hardwood. Domtar operates one sawmill and trades cutting rights to independent suppliers in exchange for chips and cuts some pulpwood for delivery to the mill. Control of destructive insect infestations is an ongoing challenge in parts of the limits.

Trenton mill

This mill produces corrugating medium from hardwood. Approximately 20% is harvested on Domtar's own limits near the mill. The balance is obtained from independent local suppliers. The Trenton mill is the only major hardwood user in the area, which contains an abundant supply of low-cost fibre.

Mississauga mill and recycling operations

The Mississauga mill, which produces linerboard and corrugating medium, recycles old corrugated containers and other waste fibre as its primary raw material.

Domtar operates waste paper recycling plants in Toronto, Montreal and Buffalo, New York. They have a combined capacity to salvage, process and supply approximately 124,000 tonnes a year of waste paper as secondary fibre to Domtar's mills and other Canadian manufacturers. The recycling operation also acts as a waste paper broker.

A. Domtar's Forest Management Agreements with the Ontario government emphasize softwood regeneration and effective forest management.

B. Hardwood limits in the Trenton area supply the containerboard mill with low-cost fibre.

C. Recycled corrugated containers, being fed into the pulper, are the primary raw material used in Domtar's containerboard mill in Mississauga.

DOMTAR'S NATURAL RESOURCES

Chemicals Group

Goderich rock salt mine

The mine is operated under a long-term mineral lease from the Government of Ontario and is strategically located with access to low-cost water transportation on the Great Lakes. With an annual capacity of 3.2 million tonnes, the mine taps a vast salt deposit known as "the Michigan Basin", covering literally millions of hectares and extending below portions of Ontario, Michigan, Illinois and Lakes Huron and Erie. The salt is mined 550 metres (1,800 feet) below the surface. The mine consists of 80 kilometres (50 miles) of tunnels covering approximately 260 hectares (1 square mile) and extending 3 kilometres (2 miles) out under Lake Huron. At current production levels, the mined area advances by 25 hectares (one-tenth of a square mile) per year.

Cote Blanche rock salt mine

Proven salt reserves at this mine on the Louisiana coast are sufficient to maintain current and anticipated production levels for at least 25 years. The salt is mined 427 metres (1,400 feet) below sea-level. The orebody is a salt dome with a stable geological structure, well-suited for mining by conventional methods. Salt products from this mine are moved to market by the Mississippi River system.

Evaporated salt

Evaporated salt is produced at plants at Amherst, Nova Scotia and Unity, Saskatchewan under mineral leases from the provincial governments, and a plant in Goderich where Domtar owns the mineral rights. Reserves are sufficient to maintain current and foreseeable production levels for 25 years.

The plants are located above underground salt deposits into which water is pumped. The resulting brine returns to the surface where the salt is extracted by a vacuum evaporation process. Although energy-intensive, requiring 85 cubic metres (3,000 cubic feet) of natural gas or its equivalent to produce a tonne of evaporated salt, the process yields a product of exceptional purity, suiting it for use in a range of food processing and consumer products.

Wood preserving division

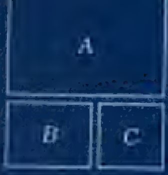
Wood products are pressure-treated for railway, utility and construction use, using preservative chemicals produced by Domtar and other suppliers and timber supplied by the customer, or obtained from the Corporation's forest lands or from independent suppliers.

Chemical specialties division

Using mainly petroleum products supplied by other manufacturers, the division produces surfactants and other chemicals used in the manufacture of detergents.

Coal tar products division

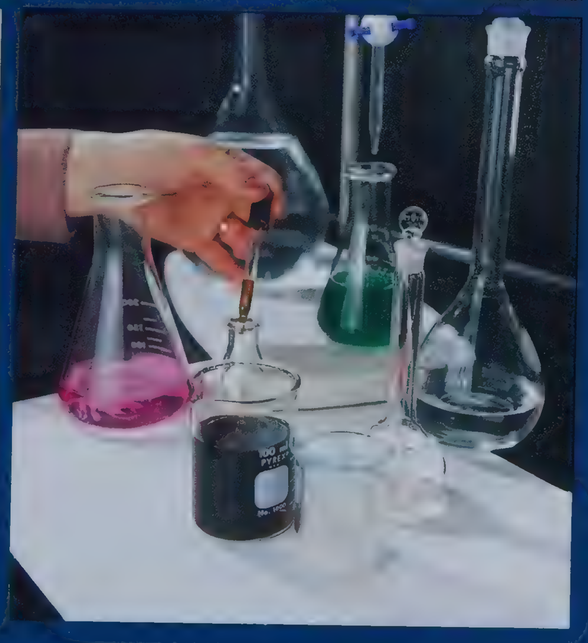
The division manufactures coal tar pitch and distillates from coal tar supplied by regional steel mills.



A. Working 550 metres below Lake Huron, miners at Goderich drill a pattern of blast-holes in the salt face, 13 metres high.

B. Preservative chemicals, including creosote which Domtar distills from coal tar, are the basis for the pressure treatment of wood products for railway, utility and construction use. Much of the timber used in these products comes from Domtar lands.

C. These chemicals are the starting ingredients for Domtar's surfactants used in the manufacture of detergents.



DOMTAR'S NATURAL RESOURCES

Construction Materials Group

Gypsum products

The relatively few deposits of gypsum ore in North America are mainly distributed in a broad belt extending from Ontario to Texas. Other major commercial deposits are located in Atlantic Canada and on the West Coast of Mexico.

Domtar currently uses approximately 2 million tons of gypsum ore per year, almost all of which is supplied from Domtar's own deposits.

The Corporation's principal ore reserves are of good quality and are ample for over 25 years of wallboard production as well as for likely future growth. The reserves are also geographically well-positioned, as follows:

- Caledonia, Ontario and Grand Rapids, Michigan adjacent to Domtar wallboard plants.

- Gypsumville, Manitoba and Canal Flats, in Eastern British Columbia supply Domtar plants in Manitoba, Saskatchewan, and Alberta.

- San Marcos Island, Mexico supplies by ship Domtar's three plants on the Western United States seaboard and the Vancouver, B.C. plant.

- Windsor, Nova Scotia.

Laminate products

Arborite® high-pressure laminates are manufactured in Montreal and Toronto from paper and melamine resins.

Cladboard® low-pressure laminates are melamine-covered particleboard made at Domtar's Huntsville, Ontario plant from wood particles supplied by nearby sawmills. The Cladboard® products plant in Georgia uses particleboard from United States suppliers.

Roofing and fibreboard products

Domtar's asphalt roofing shingles, roll roofing and roofing felts are made at four plants across Canada from asphalt, wood shavings, lime and crushed rock, all of which are purchased from other suppliers.

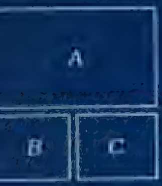
Domtar also manufactures fibreboard products for roof insulation, sheathing, panelboard and ceiling tiles from wood waste.

Masonry products

Domtar operates two plants in Mississippi, with ample shale deposits to produce distinctive light-coloured brick with special architectural appeal, as well as regular grades for residential use.

Home insulation products

Domtar is the largest Canadian distributor of Fiberglas(*), an insulation product manufactured from mineral fibre by Fiberglas Canada Inc.



A. Vast reserves of ultra-pure gypsum ore in Baja California, Mexico supply Domtar's wallboard operations from Southern California to Vancouver.

B. Wood particles and plastic resin are the two raw materials used in Cladboard® products, Domtar's low-pressure laminates used in furniture, wall units and cabinets.

C. Purchased asphalt, lime, wood shavings and crushed rock are the basic ingredients of Domtar's roofing shingles.

DOMTAR'S NATURAL RESOURCES

Energy Group

Since entering the energy business in 1979. Domtar has participated in the development of the Elmworth-Wapiti gas field in west central Alberta. As a result, this represents most of Domtar's current energy revenues.

Domtar's share of the Elmworth-Wapiti gas field consists of 60 billion cubic feet of gas under contract to TransCanada PipeLines Limited. During 1985 only about 55% of the gas contracted for was sold. This leaves potential for increasing sales in the recently deregulated natural gas markets of Canada and the United States.

Since 1983 Domtar has established its own successful ongoing exploration and development program for oil.

Since the start of this program. Domtar has drilled 90 gas or oil wells with an average success rate of 70%. In addition, 10 wells have been drilled by others as "farm-ins" on Domtar-interest lands.

A
B

A. Staff geologists in Domtar's Calgary office review well logs from a recent discovery in Southern Alberta.

B. Roughnecks work around the clock to drill a Domtar-interest gas well in the Elmworth-Wapiti field.

Management's statement on responsibility for financial reporting and control

Management is responsible for the preparation and presentation of the information contained in the Annual Report. The consolidated financial statements included in the Annual Report are considered by management to present fairly the Corporation's consolidated financial position and results of operations.

These statements, including the notes thereto (pages 27 to 42) have been:
- used to derive the financial information in other parts of the Annual Report;
- prepared in accordance with generally accepted accounting principles;
- approved by the Board of Directors, and
- examined by the Corporation's auditors, Price Waterhouse and Raymond, Chabot, Martin, Paré, whose report is presented on page 28.

To express an opinion on the consolidated financial statements, the auditors develop and maintain an understanding of Domtar's accounting procedures and internal financial controls. These internal controls are designed to provide reasonable assurance that the Corporation's:
- written policies and procedures are followed;
- transactions are executed in accordance with appropriate authorizations;
- books, records and financial statements properly reflect the transactions of the Corporation;
- systems of internal control and organizational structure provide for appropriate delegation of authority and segregation of duties.

The system of internal control is monitored by the Corporation's internal auditors, whose function includes the review and the evaluation of the accounting records and related systems.

An Audit Committee composed of 5 directors, none of whom are officers of the Corporation, is appointed by the Board of Directors. Acting on behalf of the Board, the Committee:
- reviews the Corporation's annual consolidated financial statements;
- approves major accounting policies;
- periodically reviews with management and auditors the adequacy of the Corporation's principal internal controls.

The auditors of the Corporation have free and independent access to the Audit Committee and meet with the Committee periodically during the year to consider these and other matters.

Domtar Inc.
Five-year review of supplementary segmented information

(millions of Canadian dollars)

	% of total	1985	1984	1983	1982	1981
Trade sales†						
Fine papers	25.3	$ 538.9	$ 554.2	$ 492.2	$ 466.2	$ 424.3
Newsprint, groundwood specialty papers, pulp & lumber*	16.4	350.1	341.8	366.2	368.3	428.9
Total pulp & paper	41.7	889.0	896.0	858.4	834.5	853.2
Packaging	17.6	375.4	342.6	290.2	256.2	298.1
Chemicals	13.5	286.3	281.9	260.5	269.8	255.6
Construction materials	26.9	572.7	518.4	406.0	322.6	354.8
Gas & oil	0.3	6.1	5.4	4.9	3.5	3.0
	100.0	$2,129.5	$2,044.3	$1,820.0	$1,686.6	$1,764.7
Operating profit†						
Fine papers	26.0	$ 45.7	$ 60.4	$ 46.2	$ 34.9	$ 16.7
Newsprint, groundwood specialty papers, pulp & lumber*	9.4	16.4	8.3	6.7	10.3	46.8
Total pulp & paper	35.4	62.1	68.7	52.9	45.2	63.5
Packaging	18.9	33.1	37.7	17.5	(3.4)	21.8
Chemicals	13.3	23.4	13.7	13.3	24.0	27.2
Construction materials	31.4	55.2	36.8	11.5	(26.2)	(9.7)
Gas & oil	1.0	1.7	1.8	1.8	(4.1)	(1.8)
	100.0	$ 175.5	$ 158.7	$ 97.0	$ 35.5	$ 101.0
Net operating assets†						
Fine papers	15.6	$ 172.6	$ 172.0	$ 147.5	$ 143.7	$ 166.6
Newsprint, groundwood specialty papers, pulp & lumber*	23.6	260.5	263.3	226.3	208.4	217.9
Total pulp & paper	39.2	433.1	435.3	373.8	352.1	384.5
Packaging	19.2	211.7	201.7	188.5	198.4	137.4
Chemicals	15.0	166.0	161.2	159.6	126.8	123.1
Construction materials	20.8	228.9	225.0	202.2	193.4	217.1
Gas & oil	5.8	64.1	61.8	58.2	58.8	54.5
	100.0	$1,103.8	$1,085.0	$ 982.3	$ 929.5	$ 916.6
Return on average net operating assets						
Fine papers		26.5%	37.8%	31.7%	22.5%	10.7%
Newsprint, groundwood specialty papers, pulp & lumber*		6.3	3.4	3.1	4.8	22.9
Total pulp & paper		14.3	17.0	14.6	12.3	17.6
Packaging		16.0	19.3	9.0	(2.0)	16.2
Chemicals		14.3	8.5	9.3	19.2	23.4
Construction materials		24.3	17.2	5.8	(12.8)	(5.3)
Gas & oil		2.7	3.0	3.1	(7.2)	(3.5)
		16.0%	15.4%	10.1%	3.8%	11.9%
Pulp & paper production (metric tons)						
Newsprint & groundwood specialty papers		366,364	384,694	359,139	351,319	383,137
Fine & specialty papers		350,744	331,015	328,524	303,859	236,356
Market pulp		62,846	95,890	168,794	138,351	211,470
Kraft paper & boxboard*		39,745	41,325	99,769	125,654	122,797
Containerboard		352,156	351,572	301,614	254,533	332,943

†See definition on page 46
**Includes a kraft paper and boxboard mill sold in 1983.*

Financial review

The year in review

Net earnings in 1985 amounted to $110 million or $2.70 per common share, compared to $90 million or $2.34 per common share in 1984. In both years, extraordinary gains were realized from using prior years' tax losses in the United States and the sale of certain assets. These totalled $14 million or $0.37 per common share in 1985 and $4 million or $0.12 per common share in 1984.

All per-share amounts in this report reflect the two-for-one stock split which occurred on June 14, 1985. On June 26, 1985, an additional 3.4 million common shares were sold, which increased the average number of common shares outstanding in 1985 to 38.6 million, compared to 36.6 million in 1984.

Sales in 1985 totalled $2.1 billion. The 4% increase over 1984 was generated mainly by the Construction Materials Group. The Corporation sells 67% of its products in Canada, 31% in the United States and the remaining 2% to other countries.

Although total operating profit continued to improve, amounting to $176 million compared to $159 million in 1984, results varied from one Operating Group to another. The operating profit contribution by each Operating Group is outlined on the opposite page.

Pulp & Paper Products Group

Fine papers

Sales decreased by 3% in 1985 to $539 million, while operating profit declined to $46 million from $60 million in 1984. The addition of new production capacity in the United States and the increased availability of imports in North America resulted in significant price deterioration during the year. North American demand for fine papers continued to be healthy. Domtar's sales volume increased by 3% despite a temporary slowdown in the coated board market.

The weakness of the Canadian dollar relative to the United States dollar and the lower cost of pulp had a positive effect on profitability.

Newsprint, groundwood specialty papers, pulp and lumber

Sales increased 2% in 1985 to $350 million, while operating profit increased to $16 million from $8 million in 1984.

Newsprint and groundwood specialty papers In 1985, newsprint demand in North America increased 1.5% over the 1984 level. The strong United States dollar distorted normal trade patterns and attracted offshore and Canadian producers to the United States market. As a consequence, the selling price of newsprint did not increase in 1985. Both the newsprint and groundwood specialty papers businesses benefitted from the carryover effect of 1984 price increases and from the weak Canadian dollar in relation to the United States dollar. Domtar's newsprint shipments remained at the 1984 level. Demand in North America for groundwood specialty papers increased by 3% from 1984. However, Domtar's shipments fell by 16%, due mainly to reduced production while new equipment was being commissioned. The completion of the final phase of the conversion to 100% thermo-mechanical pulping reduced fibre costs at the groundwood specialty papers mill at Donnacona, Québec. The net overall result was a significant increase in operating profit in 1985.

Pulp North American pulp shipments in 1985 were 3.8% above the 1984 level. However, due to over-capacity and high inventory levels, selling prices were 15% below those of 1984. The Group's kraft pulp mill at Lebel-sur-Quévillon resumed operations on May 10, 1985, following an 11-month strike. The operating loss increased in 1985.

Lumber Housing starts in the United States remained strong at approximately the 1984 level. Prices fluctuated during the year but on balance were about the same as in 1984. The volume of lumber sold by the Forest Products division increased by 22%.

The Forest Products division held the unit cost of wood at the 1984 level, as productivity gains realized from the mechanization of operations offset the effects of inflation.

Packaging Group

Group sales increased 10% in 1985 to $375 million, while operating profit declined to $33 million from $38 million in 1984. The sales increase was primarily the result of higher shipments of corrugated containers due to the strong Canadian economy in 1985. The oversupply of containerboard in the United States market prevented a price increase in 1985; however, the Group did benefit from the carryover of mid-year 1984 price increases for both corrugated containers and containerboard. These factors were insufficient to offset inflationary increases in operating costs.

The 1985 results include the operations of the sawmill at White River, Ontario, which was purchased in late 1984 to support the fibre requirements of the Red Rock mill. While this operation added to sales volume, it had a negligible effect on profits.

Chemicals Group

After excluding the results of the Lime business which was sold in 1984, Group sales increased by 5% in 1985 to $286 million. Operating profit increased significantly to $23 million from $14 million in 1984.

Sifto® salt Despite a three-month strike at the Group's Goderich mine, sales volume increased due to strong weather-related demand for ice-control salt. Selling prices were also higher, resulting in a significantly improved operating profit in 1985. During the year, the division successfully defended itself against the charge of allegedly dumping rock salt into the United States.

Chemical specialties Sales increased by only 1% in 1985. Higher volumes were more than offset by lower selling prices and higher operating costs, resulting in a lower operating profit in 1985.

Coal tar products Sales and operating profit were significantly lower than in 1984 due to reduced shipments of pitch and lower selling prices of coal tar distillates.

Treated wood products Higher selling prices resulted in a 6% increase in sales revenues in 1985 and a substantial profit improvement.

Construction Materials Group

Group sales in 1985 totalled $573 million. After excluding the results of the Canadian masonry operations, which were sold during 1985, this represented a 12% increase over 1984. Operating profit increased significantly to $55 million from $37 million in 1984. In Canada, housing starts increased by 23% to 166,000 units, stimulated by declining mortgage rates, while in the United States housing starts remained at the 1984 level of 1.7 million units.

Gypsum wallboard Shipments within Canada were slightly above the 1984 level. Demand in the Northeastern United States continued strong throughout the year. The adverse impact of the strike at the gypsum wallboard plant in Caledonia, Ontario was partially offset by the additional sales volume from two plants in Western Canada which were acquired in June. In the Western United States, sales volumes exceeded the 1984 levels due to a strong housing market in California. Selling prices in all markets improved. The higher sales volumes and better selling prices, combined with manufacturing efficiences, resulted in a significant increase in operating profit in 1985.

Roofing, fibreboard and insulation products Sales increased by 9% in 1985. Demand for roofing products in Western Canada remained depressed. However, better selling prices for all products and improved manufacturing efficiencies resulted in higher operating profit.

Arborite® and Cladboard® products Sales of laminated products increased by 22% in 1985 as a result of operating the newly acquired Cladboard® products facility in the United States and increased penetration of that market. However, operating profit declined, due to high start-up costs associated with the new facility.

Gas and oil investments

Gas and oil production increased slightly in 1985. Liquids volume increased significantly due to start-up of two liquids extraction plants in late 1985. Oil prices were lower due to market conditions, while gas prices declined due to deregulation in the United States. Operating costs and depletion charges were higher. Positive government initiatives have reduced taxes, with further benefits accruing in 1986. The net result was that operating profit remained at the 1984 level.

Corporate

Interest Due to increased capitalized interest on major capital projects, interest charged against earnings was $30 million, 10% lower than in 1984.

Income taxes The effective tax rate on the worldwide income of the Corporation was 36.3%. The effective rate on Canadian income was 41.5%, slightly below the Canadian statutory rate as a result of various credits and allowances available in Canada. The effective rate applicable to the income of the Corporation's various foreign subsidiaries was 28.1%.

As a result of a change in accounting method, the Corporation's income tax expense is reported before the deduction of investment tax credits earned in the year, which are included as deferred credits on the balance sheet. The Corporation will claim $13.8 million of investment tax credits against its 1985 Canadian taxes payable. These are shown as a source of cash in the Consolidated Statement of Changes in Cash Position. The net result is that the Corporation will pay $7.6 million in income taxes for 1985.

The utilization of prior years' tax losses in the United States has resulted in an extraordinary gain of $11.5 million in 1985.

As at December 31, 1985, the Corporation's subsidiaries in the United States have U.S. $9.7 million of loss carry-forwards for which the tax benefit has not been reflected in earnings. The Corporation also has $15.7 million of recorded but unclaimed Canadian investment tax credits. The U.S. losses can be utilized up to 1998, while the Canadian investment tax credits will expire in various amounts each year until 1992.

Returns

To assess its performance, the Corporation uses two criteria. First, each of Domtar's businesses is measured by its operating profit return on net operating assets (ROA). The Corporation's current target is for each business to achieve a five-year average ROA of 20%. No Operating Group achieved this target during the five years ending in 1985, while in 1985 their ROAs ranged from 14% to 24%. Secondly, Domtar measures itself by the return generated on its common shareholders' equity (ROE). The table below shows the Corporation's ROA and ROE for the past five years:

	Five-Year Average	**1985**	1984	1983	1982	1981
ROA	12%	**16%**	15%	10%	4%	12%
ROE	8%	**12%**	13%	7%	1%	9%

The ROE reflects the Corporation's low ROA combined with the low debt to equity ratio (leverage) of the Corporation that existed during this period.

The "total return to investors" will be of interest to some individual shareholders. The concept is similar to The Toronto Stock Exchange's "Total Return Index", which reflects both the share price change and dividends paid that were assumed to be reinvested in shares of the same corporation. The results for Domtar are:

	1985	1984	1983	1982	1981
Dividend paid per common share	**$ 0.79**	0.60	0.50	0.75	1.00
Share price at year-end	**$23.25**	16.75	15.19	10.06	10.94
Total return to investors*					
- 1 year	**44.5%**	14.5%	56.5%	—	(16.3)%
- 5 year	**16.1%**	12.8%	11.1%	12.9%	13.0%

*See definition on page 46

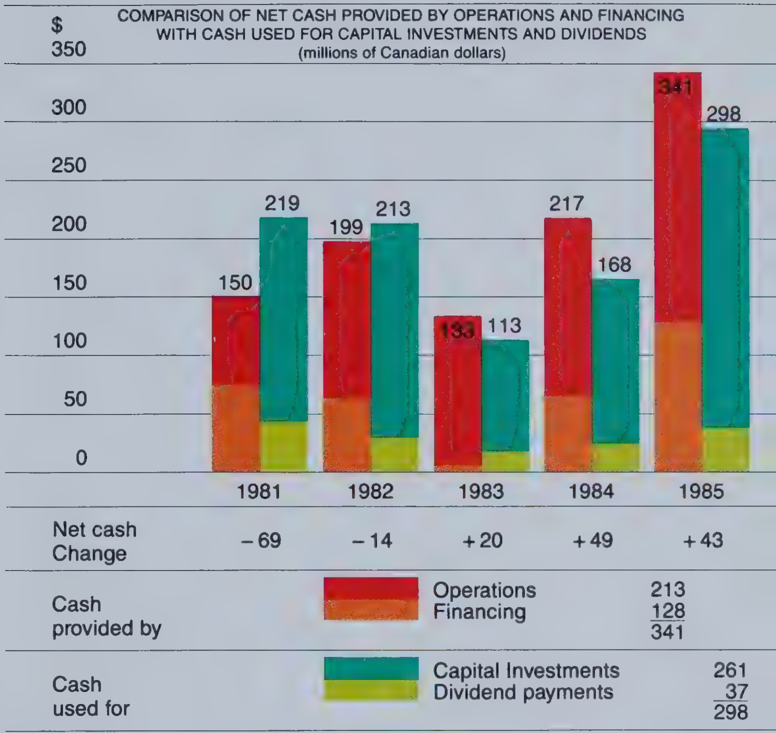
Changes in cash position

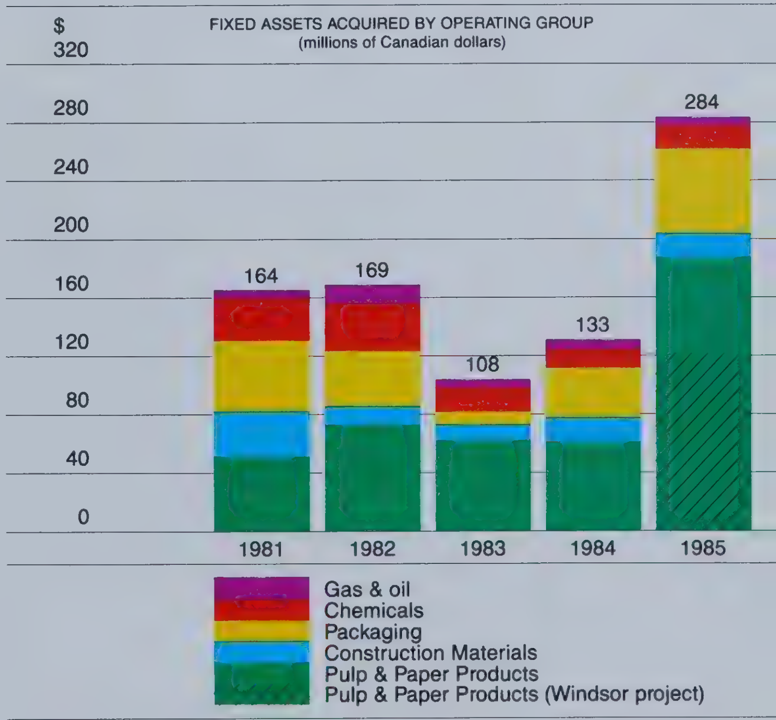
The chart in the adjoining column illustrates the changes in the Corporation's cash position during the past five years. Compared to the presentation in previous Annual Reports, some adjustments have been made to better present the net cash flow and its key components. The change results from reclassifying certain non-operating payables. The items involved are dividends payable, debt due within one year and payables on capital projects.

Operations The net cash flow from operations increased by 41% in 1985 to $213 million due to the higher levels of earnings and deferred income taxes. This included an operating working capital reduction of $5 million during 1985 in contrast to a $30 million increase in 1984. In 1985, receivables increased by $20 million due to higher sales, while the number of days' sales outstanding declined to 40 days from 42 days in 1984. Inventories rose by only $7 million as the number of days of inventory on hand fell to 44 days supply from 48 days at December 31, 1984. These were offset by an increase in payables.

Financing During 1985, Domtar was one of the first Canadian corporations publicly to issue common shares combined with the sale of investment tax credits, raising $75 million in the process. The Corporation received the initial $30 million installment on the interest-free $150 million loan from the Federal and Québec governments repayable in 10 years. Government grants totalled $20 million, of which $14 million was received from the Québec government in connection with the Windsor project. A U.S. $50 million bank loan was repaid, then reborrowed. Long-term debt was reduced by $12 million through other repayments.

Capital investments In 1985, Domtar spent $284 million on its capital expenditures program, of which $121 million related to the Windsor rehabilitation program.





The newsprint mill in Dolbeau launched its conversion to 100% thermo-mechanical pulping. The Packaging Group modernized and upgraded a corrugated containers plant in Toronto and installed a new corrugating medium machine at its mill in Trenton, replacing an old one with less capacity. The Chemicals Group completed the installation of energy conservation equipment in the Sifto® Salt division's evaporation plant at Amherst. All Operating Groups also upgraded facilities to improve quality and productivity and to reduce operating costs.

The Corporation purchased two gypsum wallboard plants in Western Canada. Also, its masonry business in Canada and solar salt facilities in Utah were sold.

The net expenditure on capital investments was $261 million.

Dividends $37 million was paid in 1985, $31 million on common shares and $6 million on Series A Preferred and Preference shares. The quarterly dividend on common shares was raised by 25% in the third quarter of 1985 to $0.22 from $0.175 per share. As a result, the annual dividend was $0.79 per share in 1985, compared to $0.60 in 1984.

Liquidity and capital resources

Domtar continues to be in a strong financial position. Cash at the end of 1985 amounted to $180 million. The ratio of current assets to current liabilities continues healthy at 2.0:1, down from 2.8:1 at December 31, 1984 principally as the result of an increase in long-term debt due within one year. The ratio of long-term debt to shareholders' equity strengthened to 24:76, compared to 30:70 at the end of 1984, due to a combination of the 1985 issue of common shares, an increase in retained earnings and less long-term debt. An "A" bond rating has been maintained.

In 1985, the Corporation negotiated with a syndicate of financial institutions a revolving credit agreement for $500 million. This agreement is for a period of 18 months and may be replaced quarterly, by mutual consent, by successive replacement agreements, each for a period of 18 months, the last one of which will expire no later than January 31, 1996. Assuming replacement agreements, the amount will decline starting January 31, 1991 until the termination of the agreement.
The Corporation also has a revolving credit agreement expiring in October, 1986 for $430 million with a Canadian bank. Other unused lines of credit total $146 million and are subject to periodic review.

In January 1986, the Corporation announced the issue of $75 million, Series B Preferred Shares with an 8.4% annual dividend for five years and a floating dividend thereafter at 72% of the prime bank rate.

Domtar Inc.
Consolidated statement of earnings

Year ended December 31
(millions of Canadian dollars, except per share amounts)

	1985	1984 (Restated) (note 2)	1983 (Restated) (note 2)
Sales	$2,129.5	$2,044.3	$1,820.0
Operating expenses			
Cost of sales	1,709.7	1,654.0	1,510.8
Selling and administrative	162.5	159.2	141.9
Research	7.0	5.2	4.9
Depreciation and depletion	74.8	67.2	65.4
	1,954.0	1,885.6	1,723.0
Operating profit (note 15)	175.5	158.7	97.0
Corporate expenses	13.0	12.2	10.0
Sundry income, net of expenses	(18.4)	(18.9)	(1.4)
Interest expense (note 10)	29.6	32.9	29.9
Earnings before income taxes, minority interest and extraordinary items	151.3	132.5	58.5
Income taxes (note 11)	54.9	45.8	18.6
Earnings before minority interest and extraordinary items	96.4	86.7	39.9
Minority interest	0.3	0.6	1.1
Earnings before extraordinary items	96.1	86.1	38.8
Extraordinary items (note 12)	14.3	4.4	(0.7)
Net earnings	$ 110.4	$ 90.5	$ 38.1
Per common share (note 8)			
Earnings before extraordinary items	$2.33	$2.22	$1.05
Net earnings	$2.70	$2.34	$1.03
Dividends	$0.79	$0.60	$0.50

See accompanying notes to financial statements

Domtar Inc.
Consolidated balance sheet

December 31
(millions of Canadian dollars)

Assets	1985	1984 (Restated) (note 2)
Current assets		
Cash and short-term investments	$ 179.9	$ 137.5
Receivables, less allowance for doubtful accounts of $9.1 (1984 - $8.7)	269.1	249.3
Inventories (note 3)	245.2	238.5
Prepaid expenses	8.2	8.3
	702.4	633.6
Investments and advances	23.2	26.4
Fixed assets		
Plant, machinery and facilities	1,545.3	1,432.2
Timber limits and land	54.4	44.0
Gas and oil properties	76.3	71.7
Assets under construction	157.9	23.2
	1,833.9	1,571.1
Less: Accumulated depreciation and depletion	771.6	716.4
	1,062.3	854.7
Intangible assets and deferred charges (note 4)	10.9	6.7
	$1,798.8	$1,521.4

Auditors' report

To the shareholders of Domtar Inc.:

We have examined the consolidated balance sheet of Domtar Inc. as at December 31, 1985 and the consolidated statements of earnings, retained earnings and changes in cash position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1985 and the results of its operations and the changes in its cash position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year, after giving retroactive effect to the change in the method of accounting for investment tax credits as described in note 2 to the consolidated financial statements.

Price Waterhouse
Chartered Accountants

Raymond, Chabot, Martin, Paré
Chartered Accountants

Montréal, February 6, 1986

Liabilities and shareholders' equity	1985	1984 (Restated) (note 2)
Current liabilities		
Trade and other payables	$ 229.0	$ 201.4
Payables on capital projects	32.0	16.0
Income and other taxes payable	8.7	7.1
Dividends payable	1.6	1.6
Long-term debt due within one year (note 6)	77.7	3.8
	349.0	229.9
Long-term debt (note 6)	275.7	313.4
Deferred income taxes	225.4	192.4
Deferred credits	73.1	46.1
Minority interest	3.8	4.3
Preferred shareholders' equity (note 8)	75.7	76.2
Common shareholders' equity		
Common shares (note 8)	343.8	277.6
Retained earnings	456.2	384.4
Accumulated foreign currency translation adjustments (note 9)	(3.9)	(2.9)
	796.1	659.1
	$1,798.8	$1,521.4

See accompanying notes to financial statements

Approved by the Board:

Yves Pratte, Q.C., Director
James H. Smith, Director

Domtar Inc.
Consolidated statement of changes in cash position

Year ended December 31
(millions of Canadian dollars)

	1985	1984 (Restated) (note 2)	1983 (Restated) (note 2)
Cash provided by (used for):			
(A) Operations	$ 213.0	$ 150.9	$126.1
(B) Financing	127.7	66.2	6.4
(C) Capital investments	(261.4)	(142.6)	(94.1)
Dividend payments	(36.9)	(25.2)	(18.7)
Increase during the year	42.4	49.3	19.7
Cash at beginning of year	137.5	88.2	68.5
Cash at end of year	$ 179.9	$ 137.5	$ 88.2
(A) **Operations**			
Earnings before extraordinary items	$ 96.1	$ 86.1	$ 38.8
Items not requiring cash:			
Depreciation and depletion	74.8	67.2	65.4
Deferred income taxes	33.5	23.9	13.8
Other	0.8	(0.4)	1.6
Cash flow from operations	205.2	176.8	119.6
Cash provided by (invested in) operating working capital (see page 31)	5.1	(29.5)	5.7
Foreign currency translation adjustments relating to operating working capital of self-sustained operations	2.7	3.6	0.8
Net cash flow from operations	$ 213.0	$ 150.9	$126.1
(B) **Financing**			
Long-term debt issued	$ 98.4	$ —	$ —
Long-term debt repaid	(80.2)	(24.5)	(8.1)
Preferred shares issued, net of expenses	—	63.7	—
Common shares issued, net of expenses	64.5	4.1	3.2
Investment tax credits utilized	13.8	12.5	0.9
Investment tax credits sold	11.8	—	—
Government grants for fixed assets acquired	19.7	6.4	10.4
Other	(0.3)	4.0	—
	$ 127.7	$ 66.2	$ 6.4
(C) **Capital investments**			
Fixed assets acquired	$ 284.4	$ 132.9	$107.7
Businesses purchased	16.0	27.3	—
Fixed assets sold	(19.4)	(18.0)	(24.1)
Change in payables on capital projects	(16.0)	(7.2)	2.0
Other	(3.6)	7.6	8.5
	$ 261.4	$ 142.6	$ 94.1

See accompanying notes to financial statements

Domtar Inc.
Consolidated statement of changes in cash position (cont'd)

Year ended December 31
(millions of Canadian dollars)

	1985	1984 (Restated) (note 2)	1983 (Restated) (note 2)
Cash provided by (invested in) operating working capital			
Receivables	$(19.8)	$(15.7)	$(27.2)
Inventories	(6.7)	(33.7)	6.9
Prepaid expenses	0.1	(2.8)	0.4
Trade and other payables	27.6	18.5	12.9
Income and other taxes payable	1.6	(1.4)	12.7
	2.8	(35.1)	5.7
Add back: Operating working capital at date of purchase of businesses purchased	2.3	5.6	—
	$ 5.1	$(29.5)	$ 5.7

Consolidated statement of retained earnings

Year ended December 31
(millions of Canadian dollars)

	1985	1984 (Restated) (note 2)	1983 (Restated) (note 2)
Balance at beginning of year	$384.4	$321.9	$302.5
Net earnings	110.4	90.5	38.1
	494.8	412.4	340.6
Deduct:			
Expenses on issue of shares, net of income taxes of $1.1 (1984 - $1.0)	1.7	1.3	—
Dividends declared			
Preference shares	0.5	0.5	0.5
Preferred shares	5.8	4.2	—
Common shares	30.6	22.0	18.2
	38.6	28.0	18.7
Balance at end of year	$456.2	$384.4	$321.9

See accompanying notes to financial statements

Domtar Inc.
Notes to consolidated financial statements
(millions of Canadian dollars, unless otherwise noted)

1. Summary of significant accounting policies

The financial statements have been prepared in accordance with generally accepted accounting principles in Canada.

Principles of consolidation
The accompanying financial statements include the accounts of Domtar Inc. and all its subsidiaries.

Translation of foreign currencies
The Corporation considers all the operations of its foreign subsidiaries to be self-sustaining. Consequently, it follows the current-rate method of translation of foreign currencies. Therefore all gains and losses arising from the translation of the financial statements of foreign subsidiaries are deferred in an "Accumulated Foreign Currency Translation Adjustments" account in common shareholders' equity.

The gains and losses resulting from the translation of foreign currency transactions of the Canadian legal entities are included in net earnings, except for those on long-term debt denominated in foreign currency. For such debt designated as a hedge of the net investment in foreign subsidiaries, exchange gains and losses are included in the "Accumulated Foreign Currency Translation Adjustments" account. For the remaining long-term debt denominated in foreign currency, exchange gains and losses are deferred and amortized over the remaining term of the related obligation. Exchange gains and losses pertaining to long-term debt covered by currency exchange agreements are offset against losses and gains deriving from those currency exchange agreements.

Valuation of inventories
Inventories of raw materials and operating and maintenance supplies are valued at average cost. Finished goods and work in process are valued at the lower of average cost and net realizable value and include the cost of raw materials, direct labour and certain manufacturing overhead expenses.

Investments and advances
Investments in companies over which the Corporation has significant influence are accounted for by the equity method. Other investments and advances are stated at cost.

Intangible assets and deferred charges
Intangible assets and deferred charges are recorded at cost. Goodwill and other intangibles are amortized on a straight-line basis over periods not exceeding 25 years. Expenses incurred in issuing long-term debt are amortized on a straight-line basis over the term of the related obligations.

Income taxes
The Corporation provides for income taxes on the tax allocation basis. Accordingly, deferred income tax provisions are recorded in the consolidated statement of earnings in order to reflect the income tax effects of timing differences, principally due to depreciation and depletion claimed for income tax purposes in excess of amounts recorded for financial statement purposes.

The Corporation does not provide for income taxes on undistributed income of foreign subsidiaries as such income is being reinvested in foreign operations.

Pension costs
Pension costs associated with current service are expensed and funded in the period in which the service is rendered. Past service costs remaining to be charged to operations are amortized and funded over periods not exceeding those during which funding is permitted by the applicable regulatory bodies.

1. Summary of significant accounting policies (cont'd)

Fixed assets, depreciation and depletion

Fixed assets are recorded at cost. Interest cost is capitalized on additions to property and plant which are in excess of $10 million ($1 million in 1984 and 1983) and for which the period of construction exceeds one year. The interest rate used is equal to the weighted average of the interest rates on long-term debt. Assets under construction represent those additions to property and plant on which interest is capitalized.

For timber limits and gas and oil well equipment, depletion is provided on the unit of production method. For all other assets, depreciation is provided on the straight-line method using rates based on the estimated useful lives of the assets which are generally as follows:

Buildings	Up to 40 years
Production machinery	Up to 20 years
Ships	Up to 15 years
Logging equipment	Up to 6 years
Automobiles	4 years

The Corporation follows the full cost method of accounting for gas and oil properties. Under this method, all costs incurred in acquiring, exploring and developing properties are capitalized, with Canada and the United States being considered as separate cost centres. Such costs are depleted using the unit of production method based upon the estimated proven reserves of gas and oil. The cost centres are reviewed annually and, if impairment to value is determined, the capitalized costs are written down.

The depreciation and depletion expense is reported net of the amount of amortization of deferred credits. No depreciation is taken on assets under construction.

Deferred Credits

Deferred credits comprise both government grants and investment tax credits earned in acquiring fixed assets. They are amortized on the same basis as the related fixed assets, and are reported net of accumulated amortization.

2. Change in accounting policy

Effective January 1, 1985, the Corporation changed its method of accounting for investment tax credits in accordance with a recommendation by the Canadian Institute of Chartered Accountants. Under the new method, which has been applied retroactively, the benefit of the investment tax credit earned in acquiring fixed assets is deferred and taken into earnings over the life of the related asset. Under the previous method, the benefit was taken into earnings as a reduction of income tax expense in the period in which the related asset was acquired.

The change has had the effect of decreasing net earnings by $3.4 million in 1984 ($0.09 per common share) and $2.1 million in 1983 ($0.06 per common share), and of decreasing retained earnings at January 1, 1983 by $21.6 million to give effect to the adjustments which pertain to prior years. Had the change not been made, net earnings for 1985 would have been increased by $6.8 million ($0.18 per common share).

3. Inventories

	1985	1984
Finished goods and work in process	$121.2	$118.7
Raw materials	96.0	92.0
Operating and maintenance supplies	28.0	27.8
	$245.2	$238.5

4. Intangible assets and deferred charges

	1985	1984
Goodwill and other intangibles	$ 3.6	$3.4
Debt issue expenses	1.6	2.0
Unrealized exchange losses	5.7	1.3
	$10.9	$6.7

5. Unused lines of credit

At December 31, 1985 the Corporation has an agreement with a syndicate of financial institutions for a committed unused line of credit totalling $500 million or the U.S. dollar equivalent. This line of credit is for a period of eighteen months and, upon mutual consent, is replaceable quarterly for an eighteen month period. The full amount of the line of credit will be available until January 31, 1991, and then at reducing amounts until termination on January 31, 1996.

Should the lenders choose not to replace the line of credit, Domtar Inc. has the option of transferring it to a subsidiary, concurrent with the sale of the fine paper manufacturing facilities at Windsor, Québec to this subsidiary to provide security to the lenders. Under this arrangement, the subsidiary has access to the same line of credit until January 31, 1996.

The Corporation also has a credit agreement with a Canadian bank for a committed unused line of credit totalling $430 million or the U.S. dollar equivalent. This line of credit expires in October 1986.

In addition, the Corporation has unused uncommitted bank lines of credit of $145.6 million.

Interest rates on all these lines of credit vary from bankers' acceptances (usually below bank prime) to bank prime, or are related to the London Interbank Offered Rate.

6. Long-term debt

	Maturity	1985	1984
Sinking fund debentures			
$5^5/_8$% Series "E"	1990	$ 11.5	$ 12.2
$6^3/_4$% Series "F"	1987	12.9	14.9
11 % Series "G"	1995	26.6	31.6
$9^5/_8$% Series "H" (U.S. $38.6; 1984 U.S. $41.5)	1996	53.9	54.8
$12^1/_4$% Series "I" (U.S. $42.0)	2000	58.7	55.5
$17^1/_4$% Bank loan (U.S. $50.0)	1986	69.9	66.1
$7^1/_2$% Notes (Swiss Francs 90.0)	1987	61.1	45.7
$6^3/_8$% Notes (Swiss Francs 44.0)	1989	29.9	22.4
Non-interest-bearing Notes	1995	30.0	—
Convertible Notes	1990	1.7	1.8
		356.2	305.0
Exchange adjustment arising from hedging Swiss Franc Notes to U.S. dollars		(2.8)	12.2
		353.4	317.2
Less: Due within one year		77.7	3.8
		$275.7	$313.4

Sinking fund debentures are secured by a floating charge on the assets of Domtar Inc. (as an entity), other than real and immovable properties.

The Corporation has hedged principal and interest payments on the $6^3/_8$% Swiss Franc (SF) Notes and on SF67 million of the SF90 million $7^1/_2$% Notes through currency exchange agreements with Canadian banks, pursuant to which the Corporation has agreed to exchange U.S. dollars for Swiss Francs. Hedging costs are classified in the consolidated statement of earnings as a reduction of sundry income.

In accordance with its policy on translation of foreign currencies, the Corporation has designated the Series "H" and "I" sinking fund debentures, the $17^1/_4$% Bank loan and a portion of the Notes in Swiss Francs as a hedge of its net investment in foreign subsidiaries.

In April 1985, the Corporation obtained from the Federal and Québec governments a non-interest-bearing loan of $150 million to be received, during the period 1985-89, at the rate of $30 million per year, with each portion repayable 10 years after its receipt date.

The Convertible Notes, which bear interest at the prime rate, were issued to certain officers of the Corporation and are convertible into common shares at the rate of $12.61 per share, determined on the basis of the fair market value of the common shares immediately prior to the issue of the Notes. The Notes are also redeemable at any time by the Corporation.

Long-term debt, as at December 31, 1985, due for retirement or sinking fund provisions in each of the next five years amounts to:

1986	1987	1988	1989	1990
$77.7	$80.9	$7.8	$36.1	$22.4

7. Commitments and contingent liabilities

The Corporation has commitments for capital expenditures totalling approximately $200 million at December 31, 1985.

Minimum rental commitments under operating leases, determined as at December 31, 1985 amount to:

1986	1987	1988	1989	1990	Thereafter	Total
$16.3	$13.3	$11.5	$7.4	$6.1	$27.9	$82.5

Total rental expense amounted to $19.9 million in 1985 (1984 — $16.7 million; 1983 — $17.3 million).

The Corporation is party to various claims and lawsuits which are being contested. In the opinion of management, the outcome of such claims and lawsuits will not have a material adverse effect on the Corporation.

8. Stated capital

Preference shares
There are 455,416 (1984 — 476,916; 1983 — 512,916) preference shares authorized and outstanding at a stated value of $23.50 per share. The preference shares are non-voting, redeemable at $25.00 per share and carry a cumulative cash dividend of $1.00 per annum. During 1985, 21,500 (1984 — 36,000; 1983 — nil) preference shares were purchased for cancellation for $0.3 million (1984 — $0.5 million; 1983 — nil).

Serial preferred shares
The authorized preferred shares consist of an unlimited number of preferred shares issuable in series.

There are 2,600,000 (1984 — 2,600,000; 1983 — nil) Series A Preferred Shares outstanding at a stated value of $25.00 per share. The Series A Preferred Shares are non-voting, retractable at the holders' option on April 2, 1992 at $25.00 per share, redeemable at the Corporation's option after April 1, 1992 at $25.40 per share, reducing by $0.20 per year, redeemable after April 1, 1994 at $25.00 and carry a cumulative cash dividend of $2.25 per annum. The Series A Preferred Shares rank junior to the preference shares with respect to the payment of dividends and the distribution of assets.

8. Stated capital (cont'd)

Common shares

There is no limit on the number of common shares the Corporation may issue. After giving effect to the two-for-one stock split of June 14, 1985, the changes in the number of outstanding common shares and their aggregate stated value since January 1, 1983 are as follows:

	1985		1984		1983	
	Number of Shares	$	Number of Shares	$	Number of Shares	$
Balance at beginning of year	36,838,550	277.6	36,569,336	273.5	36,337,990	270.3
Shares issued for convertible notes	3,966	0.1	31,728	0.4	39,664	0.5
Stock dividends in lieu of cash dividends	15,860	0.3	17,390	0.3	18,528	0.2
Shares issued for cash	3,541,508	65.8	220,096	3.4	173,154	2.5
Balance at end of year	40,399,884	343.8	36,838,550	277.6	36,569,336	273.5
Book value per common share at end of year (Restated - note 2)		$19.71		$17.89		$16.20

Book value per common share is the sum of the stated value of common shares, retained earnings and accumulated foreign currency translation adjustments divided by the number of common shares outstanding at the year-end.

9. Accumulated foreign currency translation adjustments

	1985	1984
Balance at beginning of year	$ (2.9)	$ (3.2)
Effect of changes in exchange rates during the year:		
On the net assets of foreign subsidiaries	9.6	12.0
On certain long-term debt denominated in foreign currency designated as a hedge of the net investment in foreign subsidiaries	(10.6)	(11.7)
Balance at end of year	$ (3.9)	$ (2.9)

10. Interest expense

	1985	1984	1983
Interest on long-term debt	$34.4	$34.7	$35.4
Less: Amount capitalized	5.6	2.2	5.9
	28.8	32.5	29.5
Interest on other indebtedness	0.8	0.4	0.4
	$29.6	$32.9	$29.9

11. Income taxes

Effective income tax rate

The income tax expense of the Corporation differed from the income taxes computed at the Canadian statutory rate and at the composite rate of the foreign countries where the Corporation operates. The principal factors causing this difference were as follows:

	1985		
	Canadian	**Foreign**	**Total**
Earnings before income taxes, minority interest and extraordinary items	**$92.6**	**$58.7**	**$151.3**
Income taxes at statutory rates of the respective countries	**$44.0**	**$17.1**	**$ 61.1**
Income tax allowances			
- manufacturing and processing	(4.5)	—	(4.5)
- inventory	(2.6)	—	(2.6)
- resource deduction	(1.4)	—	(1.4)
Other items	2.9	(0.6)	2.3
Income tax expense	**$38.4**	**$16.5**	**$ 54.9**
Effective income tax rate	**41.5%**	**28.1%**	**36.3%**

	1984 (Restated - note 2)		
	Canadian	Foreign	Total
Earnings before income taxes, minority interest and extraordinary items	$88.9	$43.6	$132.5
Income taxes at statutory rates of the respective countries	$41.4	$10.3	$ 51.7
Income tax allowances			
- manufacturing and processing	(4.6)	—	(4.6)
- inventory	(2.3)	—	(2.3)
- resource deduction	(1.0)	—	(1.0)
Other items	2.2	(0.2)	2.0
Income tax expense	$35.7	$10.1	$ 45.8
Effective income tax rate	40.2%	23.2%	34.6%

11. Income Taxes (cont'd)

	1983 (Restated - note 2)		
	Canadian	Foreign	Total
Earnings before income taxes, minority interest and extraordinary items	$48.1	$10.4	$58.5
Income taxes at statutory rates of the respective countries	$22.2	$ (4.0)	$18.2
Income tax allowances			
- manufacturing and processing	(2.1)	—	(2.1)
- inventory	(2.3)	—	(2.3)
- resource deduction	(1.2)	—	(1.2)
Unrecorded tax benefit of losses	—	3.7	3.7
Other items	2.1	0.2	2.3
Income tax expense (recovery)	$18.7	$ (0.1)	$18.6
Effective income tax rate	38.9%	—	31.8%

Unrecorded tax benefit of losses
At December 31, 1985, United States subsidiaries of the Corporation have loss carryforwards of approximately U.S. $9.7 million for which the tax benefit has not been reflected in earnings. This amount is available to reduce the United States income taxes in years up to and including 1998. The related tax benefit, when realized, will be recognized as an extraordinary item.

12. Extraordinary items

The extraordinary items consist of:

	1985	1984	1983
Reduction of income taxes arising from the use of the unrecorded tax benefit of prior years' losses of United States subsidiaries	$11.5	$ 7.2	$ —
Gain (loss) on sale of assets, net of income taxes of $0.8 in 1985 ($0.8 in 1984; $1.6 in 1983)	2.8	(2.8)	(2.1)
Proceeds in excess of book value, net of income taxes of $0.5, from insurance claims for assets destroyed	—	—	1.4
	$14.3	$ 4.4	$(0.7)

13. Related parties

The Corporation is not aware of having entered into any transaction other than on normal commercial terms and in the ordinary course of business with either of the Corporation's major shareholders, Dofor Inc. and Caisse de Dépôt et Placement du Québec or any party related thereto.

14. Pension plans

At December 31, 1985, the Corporation's liability for benefits in respect of past service remaining to be charged to operations is $16 million (1984 — $26 million). This liability is calculated on the assumption that operations will continue and on the basis of actuarial determinations used for funding purposes which reflect assumed future compensation levels, where appropriate. The amount is being amortized and funded over periods of up to 15 years in Canada and up to 35 years in the United States. The liability includes amendments improving the benefits from the main Canadian pension plans to non-unionized employees who retire prior to January 2, 1988 and to unionized employees who retire prior to May 2, 1987. Had the benefits resulting from the above amendments been extended to all future retirees, the Corporation's unfunded liability would have been increased by $40 million, to $56 million.

The market value of the net assets in trust and available for benefits at December 31, 1985 is $396.6 million (1984 — $326.6 million).

15. Segmented information

The Corporation's operations and assets by industry segment and by geographic area are as follows:

	1985	1984*	1983*	1982*	1981*
By industry segment					
Trade sales					
Pulp and paper					
Fine papers	$ 538.9	$ 554.2	$ 492.2	$ 466.2	$ 424.3
Other	350.1	341.8	366.2	368.3	428.9
	889.0	896.0	858.4	834.5	853.2
Packaging	375.4	342.6	290.2	256.2	298.1
Chemicals	286.3	281.9	260.5	269.8	255.6
Construction materials	572.7	518.4	406.0	322.6	354.8
Gas and oil	6.1	5.4	4.9	3.5	3.0
Consolidated sales	$2,129.5	$2,044.3	$1,820.0	$1,686.6	$1,764.7
Inter-segment sales	$ 19.5	$ 22.4	$ 25.4	$ 25.7	$ 25.8
Operating profit (loss)					
Pulp and paper	$ 62.1	$ 68.7	$ 52.9	$ 45.2	$ 63.5
Packaging	33.1	37.7	17.5	(3.4)	21.8
Chemicals	23.4	13.7	13.3	24.0	27.2
Construction materials	55.2	36.8	11.5	(26.2)	(9.7)
Gas and oil	1.7	1.8	1.8	(4.1)	(1.8)
	$ 175.5	$ 158.7	$ 97.0	$ 35.5	$ 101.0

**Restated - note 2*

15. Segmented information (cont'd)

	1985	1984*	1983*	1982*	1981*
By industry segment (cont'd)					
Identifiable assets					
Pulp and paper	$ 569.2	$ 531.3	$ 463.6	$ 431.6	$ 482.5
Packaging	282.9	254.0	228.9	237.3	173.6
Chemicals	208.8	197.0	195.1	164.1	157.9
Construction materials	297.1	281.4	250.0	233.4	260.4
Gas and oil	68.7	66.1	62.2	63.2	56.2
	1,426.7	1,329.8	1,199.8	1,129.6	1,130.6
Assets under construction	157.9	23.2	37.6	81.4	78.3
Corporate	214.2	168.4	112.8	106.3	93.0
	$1,798.8	$1,521.4	$1,350.2	$1,317.3	$1,301.9
Depreciation and depletion					
Pulp and paper	$ 27.6	$ 25.5	$ 25.3	$ 24.5	$ 25.1
Packaging	16.0	12.9	12.9	10.9	8.8
Chemicals	10.7	11.2	10.4	10.1	8.7
Construction materials	17.7	15.6	14.9	14.6	12.5
Gas and oil	2.8	2.0	1.9	2.6	1.2
	$ 74.8	$ 67.2	$ 65.4	$ 62.7	$ 56.3
Fixed assets acquired (excluding businesses purchased)					
Pulp and paper	$ 186.6	$ 60.6	$ 64.9	$ 75.6	$ 50.8
Packaging	57.8	34.2	8.8	35.7	49.3
Chemicals	14.8	12.5	16.9	33.3	28.8
Construction materials	17.9	16.7	10.0	11.9	29.7
Gas and oil	5.9	7.3	6.2	11.3	5.2
	283.0	131.3	106.8	167.8	163.8
Corporate	1.4	1.6	0.9	1.0	0.5
	$ 284.4	$ 132.9	$ 107.7	$ 168.8	$ 164.3

**Restated - note 2*

15. Segmented information (cont'd)

	1985	1984*	1983*	1982*	1981*
By geographic area					
Trade sales					
Canada					
Within Canada	$1,428.9	$1,375.8	$1,299.1	$1,204.1	$1,220.2
To United States	321.2	326.2	300.1	293.1	323.3
Offshore	49.0	48.2	38.5	52.4	72.6
	1,799.1	1,750.2	1,637.7	1,549.6	1,616.1
United States	330.1	293.9	180.9	128.9	119.6
Other	0.3	0.2	1.4	8.1	29.0
Consolidated sales	$2,129.5	$2,044.3	$1,820.0	$1,686.6	$1,764.7
Intercompany sales between geographic areas	$ 89.6	$ 89.8	$ 58.3	$ 46.8	$ 32.0
Operating profit (loss)					
Canada	$ 129.5	$ 126.8	$ 89.5	$ 55.7	$ 108.7
United States	36.7	23.7	(0.4)	(21.9)	(12.5)
Other	9.3	8.2	7.9	1.7	4.8
	$ 175.5	$ 158.7	$ 97.0	$ 35.5	$ 101.0
Identifiable assets					
Canada	$1,371.4	$1,152.5	$1,060.5	$1,049.2	$1,031.9
United States	193.9	181.4	157.5	141.8	139.5
Other	19.3	19.1	19.4	20.0	37.5
	1,584.6	1,353.0	1,237.4	1,211.0	1,208.9
Corporate	214.2	168.4	112.8	106.3	93.0
	$1.798.8	$1,521.4	$1,350.2	$1,317.3	$1,301.9

**Restated - note 2*

Sales to other segments reflect transfer prices at market value.

Segment operating profit represents sales less allocable expenses before corporate expenses, sundry income, interest expense and income taxes.

Segment identifiable assets are those which are directly used in segment operations or geographic areas. Corporate assets are principally marketable securities, certain non-trade receivables, prepaid items and other assets.

16. Subsequent event

The Corporation is in the process of issuing 3 million Series B Preferred Shares for total proceeds of $75 million, before expenses. The cumulative dividend on these shares is fixed at 8.4% for the next five years and thereafter will be at a floating rate of 72% of bank prime.

Quarterly financial information (unaudited)

(millions of Canadian dollars, except per share amounts)

	1st	2nd	3rd	4th	Year
1985					
Sales	$527.3	$527.5	$525.7	$549.0	$2,129.5
Gross profit	105.9	99.3	97.4	117.2	419.8
Earnings before extraordinary items	28.8	18.7	19.3	29.3	96.1
Net earnings	34.0	20.0	25.1	31.3	110.4
Per common share					
Earnings before extraordinary items	$ 0.74	$ 0.46	$ 0.44	$ 0.69	$ 2.33
Net earnings	$ 0.88	$ 0.50	$ 0.58	$ 0.74	$ 2.70
Market price					
High	$ 19¾	$ 19⅜	$ 22⅜	$ 23¼	$ 23¼
Low	$ 16⅝	$ 17½	$ 18⅛	$ 18¼	$ 16⅝
1984 (Note)					
Sales	$509.0	$522.5	$509.1	$503.7	$2,044.3
Gross profit	98.5	97.3	99.8	94.7	390.3
Earnings before extraordinary items	22.8	22.0	22.8	18.5	86.1
Net earnings	27.8	23.5	27.0	12.2	90.5
Per common share					
Earnings before extraordinary items	$ 0.62	$ 0.56	$ 0.58	$ 0.46	$ 2.22
Net earnings	$ 0.76	$ 0.60	$ 0.69	$ 0.29	$ 2.34
Market price					
High	$ 17½	$ 17⅜	$ 16⅞	$ 17⅜	$ 17½
Low	$ 15⅛	$ 15⅜	$ 14½	$ 15¾	$ 14½

Note:
Effective January 1, 1985, the Corporation changed its method of accounting for Investment Tax Credits in accordance with a recommendation by the Canadian Institute of Chartered Accountants. The quarterly results for 1984 have been restated to reflect this change.

Domtar Inc.
Eleven-year review of selected financial data (Note)

(millions of Canadian dollars, except per share amounts and statistical data)

			1985	1984	1983
Earnings	**Sales**		$2,129.5	2,044.3	1,820.0
	Expenses	Operating and corporate expenses	$1,967.0	1,897.8	1,733.0
		Sundry income, net of expenses	$ (18.4)	(18.9)	(1.4
		Interest expense	$ 29.6	32.9	29.9
		Income taxes	$ 54.9	45.8	18.6
		Minority interest	$ 0.3	0.6	1.1
		Extraordinary items	$ (14.3)	(4.4)	0.7
	Net earnings (loss)		$ 110.4	90.5	38.1
Financial position	**Assets**	Cash and short-term investments	$ 179.9	137.5	88.2
		Other current assets	$ 522.5	496.1	445.6
		Net fixed assets	$1,062.3	854.7	788.2
		Other assets	$ 34.1	33.1	28.2
		Total assets	$1,798.8	1,521.4	1,350.2
	Liabilities and shareholders' equity	Current liabilities	$ 349.0	229.9	211.1
		Long-term debt	$ 275.7	313.4	319.6
		Deferred credits	$ 73.1	46.1	42.4
		Deferred income taxes	$ 225.4	192.4	169.1
		Minority interest	$ 3.8	4.3	3.7
		Preferred shareholders' equity	$ 75.7	76.2	12.1
		Common shareholders' equity	$ 796.1	659.1	592.2
		Total liabilities and shareholders' equity	$1,798.8	1,521.4	1,350.2
Changes in cash position	**Operations**	Cash flow from operations	$ 205.2	176.8	119.6
		Other	$ 7.8	(25.9)	6.5
	Financing	Long-term debt and equity financing	$ 162.9	67.8	3.2
		Repayments and other — Net	$ (35.2)	(1.6)	3.2
	Capital Investments	Fixed assets acquired	$ 284.4	132.9	107.7
		Businesses purchased	$ 16.0	27.3	—
		Divestitures and other — Net	$ (39.0)	(17.6)	(13.6
	Dividend payments		$ 36.9	25.2	18.7
	Increase (decrease) in cash position		$ 42.4	49.3	19.7
Statistics	**Per common share**	Net earnings (loss)	$ 2.70	2.34	1.03
		Dividends	$ 0.79	0.60	0.50
		Cash flow from operations	$ 5.17	4.70	3.27
		Common shareholders' equity	$ 19.71	17.89	16.20
		Price range			
		High	$ 23¼	17½	16¼
		Low	$ 16⅝	14½	9¾
	Ratios	Total return to investors	44.5%	14.5%	56.5
		Return on common shareholders' equity	12.3%	13.0%	6.6
		Debt:equity ratio	24:76	30:70	35:65
	Other statistics	Number of common shareholders	17,706	18,812	16,796
		Number of preferred shareholders	2,698	2,950	1,175
		Common shares outstanding (millions)	40.4	36.8	36.6
		Number of employees	15,295	15,408	15,151
		Salaries, wages and benefits	$ 559.6	537.4	513.0

Note : The years 1975 to 1984 have been restated to reflect the impact of the change in accounting policy made in 1985. (See note 2 on page 33).

1982	1981	1980	1979	1978	1977	1976	1975
1,686.6	1,764.7	1,653.2	1,495.4	1,240.9	1,009.5	886.8	815.2
1,662.6	1,676.4	1,488.2	1,317.6	1,131.0	958.2	860.7	752.6
(8.5)	(12.4)	(13.1)	(6.6)	(11.5)	(7.7)	(7.9)	(7.2)
23.4	17.9	15.3	16.8	17.0	16.9	14.3	9.5
2.3	30.9	69.7	72.8	42.7	16.0	7.9	25.1
1.2	0.8	0.5	0.3	0.7	1.3	1.1	1.1
10.7	(4.2)	2.0	—	—	—	—	—
(5.1)	55.3	90.6	94.5	61.0	24.8	10.7	34.1
68.5	82.9	151.6	39.4	81.0	72.9	86.9	79.0
436.8	498.6	441.4	402.4	336.2	297.8	280.3	255.0
778.8	692.4	584.7	512.8	402.8	385.8	378.7	364.3
33.2	28.0	22.6	22.0	23.6	13.8	14.2	15.3
1,317.3	1,301.9	1,200.3	976.6	843.6	770.3	760.1	713.6
193.1	220.7	230.4	213.3	158.7	134.0	119.3	114.8
331.4	262.6	214.6	167.0	175.0	173.9	190.5	150.1
40.6	38.6	31.1	13.2	7.9	3.8	1.5	1.6
163.1	164.5	140.0	122.9	109.9	102.6	102.1	97.4
4.2	3.2	3.0	3.6	3.2	11.2	13.9	12.2
12.1	12.1	12.1	12.1	12.1	12.1	12.6	12.6
572.8	600.2	569.1	444.5	376.8	332.7	320.2	324.9
1,317.3	1,301.9	1,200.3	976.6	843.6	770.3	760.1	713.6
87.4	138.8	158.3	155.1	117.6	64.1	51.1	74.7
48.8	(64.0)	(11.7)	(24.8)	(7.5)	(2.4)	(7.1)	(3.4)
79.7	70.6	120.6	0.3	—	—	48.9	49.0
(16.7)	4.8	15.4	1.9	(12.9)	(4.8)	(9.7)	(6.4)
168.8	164.3	118.3	93.1	41.0	38.0	44.4	57.7
9.2	36.7	14.1	71.8	34.8	20.5	11.8	—
8.1	(26.7)	4.8	(18.0)	0.2	—	0.7	(9.0)
27.5	44.6	33.3	27.2	13.2	12.4	18.4	24.3
(14.4)	(68.7)	112.1	(41.6)	8.0	(14.0)	7.9	40.9
(0.15)	1.56	2.71	3.17	2.04	0.83	0.34	1.13
0.75	1.00	1.00	0.90	0.55	0.40	0.50	0.80
2.41	3.93	4.74	5.21	3.95	2.14	1.71	2.50
15.76	16.80	16.31	14.97	12.70	11.22	10.80	10.96
11	18¾	15⅜	14⅝	12⅜	8¼	13¼	12⅜
7¾	10	10⅞	11⅛	7	6⅝	6⅞	8¾
—	(16.3)%	25.8%	6.9%	70.4%	(0.4)%	(13.6)%	12.2%
0.9%	8.7%	18.2%	22.9%	17.1%	7.4%	3.2%	10.5%
36:64	30:70	27:73	27:73	31:69	34:66	36:64	31:69
17,571	18,551	20,882	19,995	20,393	22,244	23,330	25,815
1,289	1,350	1,415	1,457	1,486	1,537	1,613	1,654
36.4	35.8	34.8	29.6	29.6	29.6	29.6	29.6
15,017	17,409	18,130	18,353	17,414	16,815	17,520	17,637
480.5	473.7	419.2	389.5	337.0	297.3	273.9	232.9

Definitions of terms used in this report.

Return on common shareholders' equity (page 1)
Earnings before extraordinary items less preference and preferred dividends as a percentage of the annual average common shareholders' equity.

Trade sales (page 20)
Sales by the Corporation to customers.

Operating profit (page 20)
Sales less allocable operating expenses before corporate expenses, sundry income, interest expense and income taxes.

Net operating assets (page 20)
The identifiable assets of the business, excluding assets under construction, less related deferred credits and current liabilities, excluding payables on capital projects.

Total return to investors (page 24)
The change in the year in the common share price plus the year-end value of common shares purchased with dividends reinvested on the quarterly dividend payment dates, expressed as a percentage of the common share price at the start of the year. The cost of any brokerage commissions on purchases of shares has not been taken into account.

The return for the 5-year period is an annual compound rate of return.

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Transfer Agents and Registrars
for preference, serial preferred and common shares: Montreal Trust Company — Halifax, N.S.; Saint John, N.B.; Montréal, Qué.; Toronto, Ont.; Winnipeg, Man.; Regina, Sask.; Calgary, Alta.; Vancouver, B.C.

for common shares only:
The Bank of New York,
New York, N.Y.

Annual Meeting of Shareholders

The annual meeting of the shareholders of Domtar Inc. will be held at 11 a.m. on Wednesday, April 30, 1986 in the Château Champlain Hotel, Montréal, Québec.

Trade Marks:
Arborite®, Cladboard®, Gyproc®, Byronic® and Sifto® are registered trade marks of Domtar Inc.

Fiberglas(*) is a registered trade mark of Fiberglas Canada Inc. Domtar is an authorized distributor of Fiberglas(*) insulation products in Canada.

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Les actionnaires qui préféreraient recevoir leurs rapports en français voudront bien en aviser le Secrétaire de Domtar Inc.

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About Domtar

Domtar produces a diverse range of products at 76 mills, mines and plants in Canada and the United States, supported by a network of warehouses and sales offices. Of its sales revenue, approximately 85% is generated by its Canadian operations and 15% by its activities in the United States.

Pulp & Paper Products

Fine papers
Newsprint and groundwood specialty papers
Pulp
Lumber
Forest harvesting and management

Packaging

Corrugated containers, corrugating medium and linerboard
Composite cans
Recycled waste paper

Construction Materials

ARBORITE® high-pressure laminates and CLADBOARD® low-pressure laminates (melamine-surfaced particleboard)
Roofing, fibreboard and distribution of Fiberglas(*) insulation in Canada
Gypsum wallboard
Masonry

Chemicals

SIFTO® salt
Coal tar products
Chemical specialties
Wood preserving

Gas and Oil

Exploration for and development of gas and oil reserves in Canada and the United States.